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AT&T

Frank S. Simone
Government Affairs Director

Suite 1000
1120 20th Street, NW
Washington, D.C. 20036
202-457-2321
832-213-0282 FAX
fsimone@att.com

RECEIVED

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

June 28, 2004

Ms. Marlene Dortch
Secretary
Federal Communications Commission
445 12th Street, S.W., Room TWB-204
Washington, DC 20554

Re: Ex parte, *Sunset of the BOC Separate Affiliate and Related Requirements*, WC Docket No. 02-112, CC Docket Nos. 00-175, 01-337, 02-33

Dear Ms. Dortch:

BellSouth's "White Paper," filed on May 26, 2004, fails to rebut AT&T's showing that, as well as the relevant product market for long distance services, bundled long distance and local services are also a relevant and discrete product market for the analysis of BOC market power over long distance services provided on an integrated basis with BOC local exchange operations after the sunset of section 272 separate affiliate requirements.

AT&T has demonstrated that bundled long distance and local services are a separate product market because of their distinct consumer appeal, and because bundled long distance and local prices are not sufficiently constrained by the prices of standalone long distance and local services to prevent a "small but significant and nontransitory increase in price." As stated by BellSouth's cited authority, *Westman Comm'n Co. v. Hobart Int'l, Inc.*, 796 F. 2d 1216, 1221 (10th Cir. 1986), *cert denied*, 486 U.S. 1005 (1988), the key issue is whether the bundle itself is the "object of consumer demand." Clearly, there is specific consumer demand for bundles of long distance and local services, as BellSouth itself recently told the Commission. According to BellSouth, because of decreased costs, consumers now "seek *packages* that are increasingly an all-you-can-eat plan for minutes, no matter the distance." Comments of BellSouth, WC Docket No. 03-228, filed Dec. 10, 2003, at 14, n.25 (emphasis added).

Other evidence affirms that many consumers purchasing these bundles clearly value this "one-stop shopping" for its own sake, by showing that consumers are willing to spend additional amounts on bundles and are less likely to switch to alternative providers once they have purchased a service bundle. Additionally, because bundled long distance prices are lower than standalone long distance prices, and by virtue of their continuing dominance of the *local* service components of long distance and local bundles, a BOC could institute a "small but significant and nontransitory" price increase in bundled long distance, while still pricing it well below standalone long distance prices.

BellSouth does not show that consumers purchasing bundled services are unlikely to switch to standalone services in sufficient numbers to prevent such a price increase, and also fails to refute AT&T's showing of the substantial economies of scope that support a bundled market. BellSouth does not even support its contention that consumers can easily make price comparisons between bundled and unbundled services, because it overlooks altogether the discounted local vertical service features that are included in its bundle.

Moreover, BellSouth's assertion (p. 8) that IXCs may "quickly enter local service markets" and offer "competing bundles" fails to recognize the huge advantages that BOCs have over IXCs by virtue of their local bottlenecks. Indeed, IXCs' ability to "quickly enter local service markets" has been largely foreclosed as a result of the D.C. Circuit's vacation of significant portions of the *Triennial Review Order*. Without UNE-P, IXCs must construct or otherwise acquire the use of local network infrastructure as a condition precedent to their ability to offer local/long distance bundles. By contrast, BOCs provide the long distance component of their local/long distance bundles *almost entirely through resale of long distance services purchased from other carriers.*[1] AT&T announced on June 23, 2004 that it will stop competing for local and long distance residential customers in seven states because "for the consumer market, the ability of a competitor to bundle a variety of services -- particularly local and long distance service -- has essentially been eradicated." AT&T News Release, June 23, 2004 (statement by David Dorman, Chairman and CEO of AT&T). Similarly, another competitive carrier, Z-Tel, has announced that it will cease taking customer orders in eight states because of the D.C. Circuit decision.[2]

As AT&T has shown, bundled long distance and local services plainly meet the requirements of the DOJ/FTC *Horizontal Merger Guidelines* for treatment as a separate market for the analysis of BOC market power in this proceeding. The rapidity with which the BOCs are leveraging their local bottlenecks into this bundled market is shown by the market share data set forth in the Confidential Attachment to this filing.[3]

There also is no basis to BOC claims repeated by BellSouth that competition from VOIP and wireless services makes it unnecessary to prevent the abuse of BOC market power. VOIP is in its infancy and serves a tiny fraction of the customers served by the BOCs, while wireless services are significantly owned by the BOCs, do not avoid BOC special access wireline bottlenecks and are not fully substitutable for wireline services. Indeed, BellSouth's affiliate, Cingular, seeks FCC approval of its proposed merger with AT&T Wireless by contending in the economist declaration submitted with its transfer of control application that wireless and wireline services are *not* part of the same product market.

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[1] BellSouth acknowledges (p. 8) that BOCs "typically do not own" long distance facilities.

[2] TR Daily, *Z-Tel to Cease New Residential Business in Eight States*, June 22, 2004.

[3] Because this analysis is partially based on BOC data submitted pursuant to the Protective Order in this proceeding, it is filed under seal.

Bundled Long Distance and Local Services are a Separate Market: Longstanding antitrust precedent supports "cluster markets" of complementary products purchased from a single supplier. *See United States v. Philadelphia National Bank*, 374 U.S. 321 (1962); *JBL Enterprises, Inc. v. Jhirmack Enterprises, Inc.*, 698 F.2d 1011 (9th Cir.), *cert denied*, 464 U.S. 829 (1983). The Commission accordingly predicted in 1997 that bundled local and long distance services "may well" become a relevant product market as the BOCs obtained section 271 authority and "to the extent consumer demand for bundled service packages forces carriers to offer such bundles." *Applications of NYNEX Corporation and Bell Atlantic Corporation*, 12 FCC Rcd. 19985, ¶ 52 & n.16 (1997) (citing *Philadelphia National Bank*, 374 U.S. 321).

Today, the BOCs have section 271 authority nationwide and are offering their lowest priced long distance services only in bundled service packages. BellSouth itself contends there is specific consumer demand for these bundles. BellSouth informed the Commission in December 2003 that "the telecommunications industry has forever changed. No longer do customers look to specific carriers to provide one distance of voice calls and another carrier to provide a longer distance call." Comments of BellSouth, WC Docket No. 03-228, filed Dec. 10, 2003, at 14. According to BellSouth, "Decreased cost has increased the demand for interLATA services and has *caused consumers to seek packages that are increasingly an all-you-can-eat plan for minutes, no matter the distance*." *Id.*, n.25 (emphasis added). Similarly, SBC emphasizes that bundling plays a central role in its consumer marketing strategy and is "the future of telecom."[4]

BellSouth thus acknowledged in December 2003 that bundles of long distance and local services have an appeal to consumers that is distinct from their components -- the key attribute of a cluster market. 2 Von Kalinowsky, Antitrust Laws and Trade Regulation §24.02[3] at 24-78.12 to 24-78.13 (Feb. 2003) ("The cluster concept is most appropriately used to group products or services that are functionally related (not interchangeable but complementary) and *where the package of products or services has an appeal that is distinct from that of its components*.") (Emphasis added.)[5] Evidence that consumers "generally value[] 'one-stop shopping' for its own sake" (BellSouth, p. 6), is further shown by reports that consumers are willing to purchase additional services in bundles[6] and the lower likelihood that consumers will switch to alternative providers once they have purchased a service bundle, as described below.

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[4] SBC Communications Analyst Meeting, Nov. 13, 2003, CCBN StreetEvents, Event Transcript, Final Transcript at 2, 4-5 (Attachment B to Letter dated Feb. 3, 2004 to Ms. Marlene H. Dortch, Secretary, FCC, from Frank Simone, AT&T ("AT&T Feb. 3, 2004 *Ex Parte*")). *See also, id.* at 2.

[5] Similarly, BOCs have cited consumer demand for 'one-stop shopping' in support of their horizontal mergers. *See Applications of Ameritech & SBC Communications, Inc.*, 14 FCC Rcd. 14712, ¶ 74 (1999) ("In a number of recent merger applications before the Commission, prior applicants have pointed to consumers' demand for 'one stop shopping' and/or end to end service that is in part justifying these Applicants' merger plans"); *id.*, n.158 ("According to the Applicants, this demand stimulated in part their merger plans."); *Application of GTE Corp.*, 15 FCC Rcd. 14032, n. 259 (2000). *See also, Applications of NYNEX Corp.& Bell Atlantic Corp.*, 12 FCC Rcd. 19985, ¶ 52 (1997) ("Applicants clearly contemplate providing 'one stop shopping' to their customers.")

[6] A Banc of America Securities study filed in this proceeding by BellSouth on May 5, 2004, affirms that consumers are willing to spend more on bundled services, because "the economics of

Even BellSouth's cited authority, *Westman Comm'n Co. v. Hobart Int'l, Inc.*, 796 F. 2d 1216, 1221 (10th Cir. 1986), *cert denied*, 486 U.S. 1005 (1988), similarly makes clear that bundled long distance and local services are a relevant market. The court rejected the proposed cluster market in that case "[b]ecause the 'cluster or package' of goods is not the object of consumer demand in the restaurant equipment supply industry." The court thus made clear that the key issue in determining the existence of a cluster market is whether there is consumer demand for the package itself. That is certainly the situation with bundled long distance and local services, where BellSouth argued to the Commission in December 2003 that there is now specific consumer demand for all-distance *packages*.

Treatment of bundled local and long distance services as a separate market is also required by traditional antitrust submarket analysis, under which "within a broad market, 'well-defined submarkets may exist which, in themselves, constitute product markets for antitrust purposes." *Federal Trade Commission v. Staples, Inc.*, 970 F. Supp. 1066, 1075 (D.D.C. 1997), citing *Brown Shoe v. United States*, 370 U.S. 294, 325 (1962). In *Staples*, the court defined the relevant product market as "the sale of consumable office products through office superstores," notwithstanding the existence of "a broad market encompassing the sale of consumable office supplies by all sellers of such supplies, and that those sellers must, at some level, compete with one another." *Id.* at 1075, 1080. The evidence indicated that other sellers of office products did not sufficiently constrain office superstore pricing.

The product market analysis required by the DOJ/FTC *Horizontal Merger Guidelines* likewise is not whether unbundled long distance services compete with bundled long distance services at some level, but whether unbundled long distance services sufficiently constrain the pricing of bundled long distance services to prevent a hypothetical monopolist over bundled long distance services from imposing a "small but significant and nontransitory increase in price." AT&T demonstrated that bundled long-distance and local services must be treated as a relevant product market under this analysis, because they are priced at substantially lower levels than the aggregate of the component prices of these services, and can be provided at significantly lower costs in a

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the multi-service bundle are frequently compelling enough to generate an up sale, persuading the user to spend more money than they otherwise would to take advantage of a perceived bargain." Banc of America Securities, *Wireline Services Pricing Update* (Attachment to Letter dated May 5, 2004 to Ms. Marlene Dortch, Secretary, FCC, from Mary L. Henze, BellSouth), at 7. Verizon reports that its "Freedom" plan "has had a net favorable incremental revenue effect. More people are actually buying up in the bundle than buying down." Verizon at Citigroup Smith Barney Entertainment, Media & Telecom Conference, Jan. 7, 2004, at 4, FD (Fair Disclosure) Wire, 2004 WL 65931425. For example, BOC all distance bundles typically include low cost, high margin local vertical feature services like call waiting, caller ID and voice mail that consumers may not otherwise purchase at higher *a la carte* prices, which provide additional high-margin revenues to further support the cross-subsidization of bundled long distance services. Letter dated Nov. 26, 2003 to Ms. Marlene H. Dortch, Secretary, FCC, from Frank S. Simone, AT&T ("AT&T Nov. 3, 2003 *Ex Parte*") at 8; AT&T Reply Comments, filed July 28, 2003, at 21 & n.56. To prevent such cross-subsidies, dominant carrier regulation should be supported by service-specific imputation requirements. Selwyn *Ex Parte* Declaration, dated Jun. 8, 2004 (Attachment to Letter dated Jun. 9, 2004 to Ms. Marlene H. Dortch, Secretary, FCC, from Frank S. Simone, AT&T ("AT&T June 9, 2004 *Ex Parte*")) at 17-20.

bundle because of the high joint costs of customer acquisition, customer care, and billing.[7] AT&T also showed that general consumer preferences for bundled services would make them less likely to switch to unbundled services in response to "a small but significant and nontransitory increase in price" of the bundle. BellSouth's "White Paper" rebuts none of these showings.

Bundled Long Distance Prices Are Lower: As AT&T previously noted, the DOJ/FTC Guidelines product market analysis is based on "prevailing prices" and generally determines the effect of a "small but significant and nontransitory" price increase by using "a price increase of five percent lasting for the foreseeable future."[8] BellSouth does not dispute that bundled long distance prices are lower than unbundled long distance prices. Notably, BellSouth puts forward no data challenging AT&T's showing that many of the component services of the "all distance" bundles offered by BOCs are not available on a standalone basis, or are offered at such high prices that a BOC easily could institute a "small but significant" price increase for the bundle while still pricing it well below *a la carte* services.

BellSouth surely is wrong in arguing (p. 6) that bundling "presumably plays no role" in consumer choices of flat-rate long distance plans, when BellSouth -- like other BOCs -- *does not even offer flat-rate long distance on a standalone basis.* BellSouth's unlimited long distance is *only* available bundled with BellSouth's Complete Choice local plan.[9] In similar fashion, Qwest, SBC and Verizon also provide flat-rate long distance services *only* to their local service customers.[10] BellSouth, Qwest, and Verizon also provide their maximum discount measured use long distance plans at preferential monthly rates to their local service customers.[11] SBC goes even further and limits the

[7] AT&T Nov. 3, 2003 *Ex Parte*. *See also*, AT&T Feb. 3, 2004 *Ex Parte*.

[8] *Id.* at 6; DOJ/FTC Horizontal Merger Guidelines, Section 1.11.

[9] *See* www.bellsouth.com/apps/ipc/ICReqDispatcher?userEvent=printOfferDetailEvent ("The BellSouth Complete Choice plan is required to subscribe to the BellSouth Unlimited plan.")

[10] *See* www.qwest.com/residential/products/qcld/index.html (Qwest "Choice" plan offering long distance at 5 cents per minute with $20 per month maximum charge with a "qualifying Qwest home phone package" (which includes vertical features) (and a $25 per month maximum charge without) is "available only to Qwest local service customers for residential use"); www.02.sbc.com/Products_Services/Residential/Catalog/1,,13--1-3-13,00.html. ("National Connections" unlimited calling for $20.00 per month requires "subscription to SBC Total Connections [providing all-distance calling] or to SBC local service, Caller ID, two custom calling features and voice mail."); www22.verizon.com/ForYourHome/SAS/res_fam_InternetBund.asp?ID=PKGFLD&redirecthit=1&redirectedTo=/Foryourhome/sas/res_fam_InternetBund.asp&referrer=/Foryourhome/sas/varStateSelector.asp (Verizon unlimited long distance only available in "Freedom" bundle with local services and Home Voice Mail, Caller ID, Call Waiting, Speed Dialing and Three-Way Calling).

[11] For example, Verizon waives the $3.95 monthly charge for its 5 cent per minute long distance plan for customers purchasing a "qualifying local service package" from Verizon, which includes vertical features, and advertises this service bundle only in areas where there is a Verizon-owned ILEC. Similarly, BellSouth provides its 5 cent per minute long distance services at a lower monthly charge to subscribers to its "Answers" bundles. *See* http://www.bellsouth.com/consumer/longdistance_promo.html?res_dd=ld#. All the BellSouth "Answers" bundles include local services. *See* http://www.bellsouth.com/apps/ipc/ICReqDispatcher?userEvent=getAllOffersForACategoryEvent&catId=132&segmentId=2. *See also*, www.qwest.com/residential/products/qcld/index.html (Qwest "Choice" plan described above);

availability of all its long distance service plans to its local service customers. Moreover, high-margin local vertical features, which readily can be used to cross-subsidize bundled long-distance services, are packaged into many of these BOC local/long distance bundles.

BellSouth thus makes no showing that standalone long distance services would prevent "a small but significant and nontransitory increase in price" of bundled long distance services. BellSouth also is wrong in claiming (p. 5) that consumers may easily make price comparisons of bundled BOC long distance services with standalone long distance services. Contrary to BellSouth's assertions, the Banc of America Securities study filed in this proceeding by BellSouth on May 5, 2004, describes company web-site information as "confusing" and "incomplete" and states that "choosing the most economical plan is not simple at all."[12]

The difficulty of such comparisons is underscored by BellSouth's own failure to directly compare the same services in its "White Paper." In support of its claims, BellSouth contends (p. 5) that consumers can compare a "flat-fee plan offered by a long distance company in conjunction with BellSouth's basic service" with "BellSouth's flat-fee long distance service plus Complete Choice." However, BellSouth's unlimited long distance ($20.99 in Atlanta, GA.) is only available bundled with BellSouth's Complete Choice Local plan ($34.00 in Atlanta, GA), which includes a choice of vertical calling features in addition to basic service (available in Atlanta, GA for $17.45 per month if purchased separately). Those vertical calling features include caller ID (otherwise priced at $7.95 per month), call waiting (otherwise priced at $6.50 per month), Ringmaster service (otherwise priced at $5.00 per month), three-way calling (otherwise priced at $5.00 per month), call return (otherwise priced at $5.00 per month), and call forwarding (otherwise priced at $4.00 per month). Since a consumer opting for an IXC flat-fee plan and BellSouth's basic service would not receive these vertical calling features -- which a consumer opting for the BellSouth bundle would receive at a substantial discount -- it is clearly more difficult to compare the prices of these two sets of services than BellSouth contends, and any potential pricing constraint provided by the IXC flat fee plan is accordingly reduced.

Bundles Provide Substantial Economies of Scope: AT&T has shown that a bundled market is also supported by substantial economies of scope because the high costs of customer acquisition, customer care, billing and access allow local and long-distance services to be provided at significantly lower costs in a bundle. The CIBC report (filed Nov. 3, 2003) emphasizes that when additional services are bundled with local exchange, the costs of customer acquisition, care and billing do not significantly increase above those that are already incurred to serve local exchange customers.[13] However, no CLEC serves more than a fraction of the local service customers served by any BOC, and IXCs not also engaged in the provision of local services have no ability to

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http://www02.sbc.com/Products_Services/Residential/Catalog/1,,13--1-3-13,00.html (all SBC long distance plans require subscription to SBC local services).

[12] Banc of America Securities, *Wireline Services Pricing Update* (Attachment to Letter dated May 5, 2004 to Ms. Marlene Dortch, Secretary, FCC, from Mary L. Henze, BellSouth), at 7.

[13] CIBC World Markets, *Opportunities for Flat-rate Pricing and Bundling, Industry Update:Telecommunications Services*, June 26 2003, (Attachment to AT&T's Nov. 3, 2003 *Ex Parte*), at 16.

"piggy back" their long distance service on a local service platform, and must incur costs in each of these categories on a standalone basis.

BellSouth does not deny these economies. BellSouth merely denies (p. 8) the existence of evidence of "such substantial cost savings as to require recognition of a separate market." However, substantial economies of scope are clearly present. AT&T has shown -- without rebuttal -- that "[t]he primary costs of retail long distance service consist of access charges to ILECs, billing and collection, advertising and marketing, and customer service, all of which dwarf the miniscule costs associated with interexchange transport." Selwyn Dec, filed June 3, 2003, ¶ 95. Additionally, CIBC states that "on the cost side, approximately 20-30% of revenues in a competitive communications sector are spent on customer churn, customer care and billing" and that "[t]his expense can be cut in half through flat rate bundles."[14] These economies of scope allow carriers to offer bundled long distance services at rates significantly below those possible from *a la carte* providers. Given this cost discrepancy, *a la carte* long distance offers provide little or no pricing constraint on bundled long distance.

AT&T has further shown why those economies of scope confer huge advantages on BOCs providing bundled long distance services over IXCs providing bundled local services.[15] For example, as the dominant local exchange providers, BOCs have existing or recent relationships with approximately 90 percent of in-region customers and receive the overwhelming majority of customer-initiated (inbound marketing) contacts.[16] Because of these "prior business relationships," BOCs are permitted to initiate outbound marketing calls to 90 percent of their potential long distance customers, while "do not call" restrictions prevent IXCs from calling most potential local customers.[17]

Access charges also allow local and long-distance services to be provided at significantly lower costs in a bundle. Where long distance and local (facilities-based or UNE) services are provided to the same customer, no originating access charges are paid and terminating access charges are paid only on the customer's calls to parties served by other carriers.[18] BOCs providing bundled long distance services again derive much greater advantages from these economies than IXCs providing bundled local services, because a much larger proportion of BOC customers' long distance calls terminate within the relevant BOC regional network. In contrast, each IXC has only a small fraction of local customers and therefore must pay terminating access charges on most of its customers' calls. However, providers of standalone long distance services are disadvantaged to a much greater extent, because they must pay originating and terminating access charges on *all* their customers' calls, which further demonstrates why long distance can be provided at much lower cost when it is bundled with local services

[14] *Id.* at 20.

[15] AT&T has also shown that IXCs incur greater out of pocket costs to provide bundled services than BOCs, because IXCs incur greater UNE-P costs than the BOCs incur with resold long distance services, and IXCs also have higher marketing and advertising costs, which allow BOCs to realize much larger margins on these services. AT&T Nov. 3, 2003 *Ex Parte* at 4.

[16] *Id.* at 3-4.

[17] *Id.* at 6.

[18] *See* AT&T Comments, filed June 30, 2003, at 19. However, Verizon is seeking to impose ILEC access charges on UNE-P providers. Verizon Petition, WC Docket No. 03-157, filed Jul. 1, 2003.

and why standalone long distance can exercise no effective pricing constraint on bundled long distance.

For these and other reasons, there is no basis to BellSouth's claim (p. 8) that it obtains no cost advantage from "control of the facility used to provide all of the services in the bundle." AT&T has provided extensive evidence in this proceeding of how BOCs use their local bottlenecks to harm their competitors by engaging in price squeezes, cost misallocation and discrimination. *See* AT&T Comments at 24-45; AT&T Reply Comments at 18-22. Indeed, SBC recently *admitted* having "a cost advantage over AT&T, MCI and others because they buy a lot of their local access from us and the other regional bell companies." SBC Communications Analyst Meeting, Nov. 13, 2003, CCBN StreetEvents, Event Transcript, Final Transcript at 14 (statement by SBC Group Vice President for Marketing and Sales Rayford Wilkins at SBC's Nov. 2003 analyst meeting) (Attachment B to AT&T's Feb. 3, 2004 *Ex Parte*).[19]

BellSouth certainly fails to refute AT&T's showing that a bundled market is supported by substantial economies of scope by arguing (p. 1) that the BOCs use different (resold) facilities for long distance transport. As noted above, the costs associated with long distance transport are very much smaller than those associated with access charges, billing and collection, advertising and marketing, and customer service -- where the BOCs enjoy substantial economies of scope from providing bundled local and long distance services that not only are far greater than those available "whenever more than one related product or service is provided by a single seller" (BellSouth, p. 7) but also greatly outweigh those available to IXCs providing bundled local services.

The rapidity with which the BOCs are increasing the number of their in-region long distance customers after obtaining section 271 relief -- *almost 20 million* net additions in the past twelve months alone, according to Merrill Lynch[20] -- shows that these BOC advantages are having a dramatic impact in the market, and far outweigh any purported "offsetting advantages" possessed by IXCs. (BellSouth, pp. 7-8.) Indeed, the BOCs added more in-region long distance customers in each of the last two quarters (4.8 million in 4Q03 and 5.4 million in 1Q04) than the total number of UNE-P customers added by CLECs in the last twelve months (4.6 million).[21]

Thus, contrary to BellSouth's assertion (p. 8) that IXCs may "quickly enter local service markets" and offer "competing bundles," BOCs providing bundled long distance

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[19] This statement belies the BOC "opportunity cost" theories that are repeated here by BellSouth (p. 8). Those theories also ignore the additional BOC access revenues that result from stimulated minutes when long distance prices are reduced. AT&T also has shown that the section 272(e)(3) access imputation requirement alone will not prevent anticompetitive leverage of BOC local bottlenecks, contrary to BellSouth's claims here. AT&T Comments at 49-50; *Ex Parte* Declaration of Lee Selwyn, Jun. 8, 2004 (Attachment to AT&T June 9, 2004 *Ex Parte*).

[20] Merrill Lynch, US Wireline Services, May 7, 2004, Table 7 (showing BOC net long distance customer additions of 5.2 million in 2Q03, 4.2 million in 3Q03, 4.8 million in 4Q03 and 5.4 million in 1Q04) (Attachment to Letter dated June 9, 2004 to Ms. Marlene Dortch, Secretary, FCC, from Frank Simone, AT&T).

[21] *Id. See also,* Merrill Lynch, *US Wireline Services*, May 7, 2004, Table 9 (UNE-P line additions of 1.3 million in 2Q03, 1.2 million in 3Q03, 1 million in 4Q03 and 1.1 million in 1Q04).

services already possessed huge advantages over IXCs providing bundled local services, even before the D.C. Circuit vacated significant portions of the *Triennial Review Order*. As described above, AT&T has announced that it will stop competing for local and long distance residential customers in seven states because competitors cannot provide an effective bundle of local and long distance services without the UNE rules that are eliminated by that decision, and Z-Tel has made a similar announcement.

Consumer Preferences for Bundles Limit Competition from Unbundled Services: AT&T also has shown that there are further reasons why consumers choosing bundles including flat rate long distance plans -- which the BOCs only offer to their local service customers -- may be less likely to switch to unbundled long distance services in response to "a small but significant and nontransitory increase in price." First, AT&T has shown that many consumers appear willing to spend additional amounts for flat-rate plans. Qwest has made clear that long distance customers are "willing to pay a premium" for unlimited usage plans and "*are acting in this manner in the marketplace*."[22] CIBC similarly reports that "consumers like the certainty of flat-rate pricing in the communications market"[23] and that "[t]ime and again, most consumers choose" the simplicity and predictability of flat-rate pricing plans when given a choice.[24] Thus, ISPs have "often found that a[n] $11-$15 subscriber would jump at a $20 per month plan."[25] BellSouth does not show otherwise.

Further evidence that consumer preferences for bundled services make them less likely to switch to unbundled services in response to "a small but significant and nontransitory increase in price" of the bundle is provided by reports that consumers purchasing bundled services are generally less likely to switch to competitors. Senior SBC executives emphasized at SBC's November 2003 analyst conference that bundling reduces customer "churn" (*i.e.*, switching to services offered by other carriers) and that "[l]ong distance alone reduces the rate of churn by 9%."[26] Verizon similarly states that "the churn rate in bundled customers is about 40% less than normal." Verizon at Citigroup Smith Barney Entertainment, Media & Telecom Conference, Jan. 7, 2004, at 4, FD (Fair Disclosure) Wire, 2004 WL 65931425. The CIBC report also emphasizes (at 12) that "[b]undling reduces [customer] churn."[27]

The likelihood that a bundled long distance customer will switch to another provider is even further reduced when additional services are added to the customer's

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[22] AT&T Feb. 3, 2004 *Ex Parte* at 6, quoting Qwest Response to AT&T Interrogatory Request 02-158, Petition of Qwest Corporation to Initiate a Mass-Market Switching and Dedicated Transport Case Pursuant to the Triennial Review Order, Washington State Utilities and Transportation Commission, UT-033044, filed Jan. 21, 2004 (emphasis added).
[23] CIBC World Markets, *Opportunities for Flat-rate Pricing and Bundling, Industry Update:Telecommunications Services*, June 26 2003, (Attachment to AT&T's Nov. 3, 2003 *Ex Parte*) at 20.
[24] *Id.* at 11.
[25] *Id.*
[26] SBC Communications Analyst Meeting, Nov. 13, 2003, CCBN StreetEvents, Event Transcript, Final Transcript at 5,18 (statement by SBC Group Vice President for Marketing and Sales Rayford Wilkins). (Attachment B to AT&T Feb. 3, 2004 *Ex Parte*).
[27] CIBC World Markets, *Opportunities for Flat-rate Pricing and Bundling, Industry Update:Telecommunications Services*, June 26 2003, (Attachment to AT&T's Nov. 3, 2003 *Ex Parte*).

bundle. BellSouth Chairman and Chief Executive Officer Duane Ackerman stated at BellSouth's November 2003 analyst meeting that "[i]f you take our regular Complete Choice feature package with LD and add just one more product like DSL, dial up, or wireless, we reduce churn by 45% on that customer." BellSouth 2003 Analyst Briefing, Nov. 10, 2003, at 5, FD (Fair Disclosure) Wire, 2003 WL 622800569.

In sum, BellSouth fails to demonstrate that the Commission should limit its analysis of BOC market power in this proceeding to the market for long distance services. For the reasons set forth above, such an analysis would fail to address BOC market power over bundled long distance and local services, which is not sufficiently constrained by standalone long distance and local services, and that would allow BOCs to engage in anticompetitive pricing, cost misallocation and discrimination after the sunset of section 272 safeguards, when in-region long distance services are provided on an integrated basis. Separate treatment of bundled long distance and local services is accordingly necessary, as required by the DOJ/FTC *Horizontal Merger Guidelines*.

Lastly, as described below, BellSouth fails to show that dominant carrier regulation is unwarranted because of competition from VOIP and wireless services or because these rules are ill suited to the task at hand.

VOIP: There is no basis to BellSouth's claim (pp. 9-10) that new VOIP services make it unnecessary to prevent abuse of BOC market power, because VOIP services have an infinitesimal fraction of the customers served by the BOCs. For example, In-Stat/MDR reports that there were just 114,000 U.S. broadband IP telephony subscribers in 2003 and forecasts that this number will increase to 4.1 million in 2007 -- which is still less than the *net increase* in BOC long distance customers in *each* of the last four quarters (2Q03-1Q04) reported by Merrill Lynch.[28]

Wireless: Similar claims that wireless services will ensure wireline competition ignore the fact that wireless services are already subject to significant BOC control, even before the pending Cingular acquisition of AT&T Wireless. They also fail to recognize that wireless services are heavily reliant on BOC special access services and therefore do not avoid BOC local wireline bottlenecks. As the Commission found in the *Triennial Review Order*, wireless is "primarily a complementary technology,"[29] and the record here shows that wireless and wireline services are not fully substitutable.[30]

Tellingly, Cingular, which is controlled by BellSouth and SBC, seeks approval of its proposed merger with AT&T Wireless by contending that wireless and wireline services are *not* part of the same relevant product market. According to the antitrust economist representing Cingular and AT&T Wireless, who is a former Deputy Assistant Attorney General for Economics in the DOJ Antitrust Division, "[a]t the present time, *wireline service is sufficiently differentiated from wireless service to exclude wireline*

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[28] *See* In-Stat MDR, *Hear This: Broadband IP Telephony*, May 2004; Merrill Lynch, *U.S. Wireline Services*, May 7, 2004, Table 7.

[29] *Review of Section 252 Unbundling Obligations of Incumbent Local Exchange Carriers*, 18 FCC Rcd. 16978, ¶ 230 (2003) ("*Triennial Review Order*").

[30] AT&T Nov. 26, 2003 *Ex Parte* at 7-9; AT&T Feb. 3, 2004 *Ex Parte* at 10-11. *See also, id.* at 10 (citing statement by SBC Chairman and CEO Edward Whitaker that wireless "is never going to be the substitute. Reliability is one reason.")

from the relevant product market." Declaration of Richard Gilbert, ¶ 44 (emphasis added), Cingular and AT&T Wireless, Application for Assignments of Authorization and Transfer of Control, Mar. 18, 2004.

There also is no basis to BellSouth's assertion (p. 3) that the purpose of dominant carrier regulation is only to prevent dominant carriers from raising prices.[31] Dominant carrier tariff filing and cost support requirements address all forms of anticompetitive pricing. *See, e.g., LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area*, 12 FCC Rcd. 15756, ¶ 6 (1997) ("certain aspects of dominant carrier regulation may address" improper cost allocation, discrimination and price squeezes). As AT&T has described in its Comments and Reply Comments in this proceeding, because of the sunset of section 272 safeguards and other significantly changed circumstances since 1997, the public interest in the application of dominant carrier regulation now plainly outweighs any attendant burdens.

Sincerely,

cc: M. Carowitz
B. Childers
W. Cox
R. Crittendon
W. Dever
A. Dunnigan
K. Jackson
W. Kehoe
P. Megna
J. Minkoff
C. Rand

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[31] Contrary to BellSouth's claims (p. 7) that BOCs cannot exercise market power, BOC control of local bottleneck facilities provides the ability to exercise market power by raising their rivals' costs and restricting their rivals' output by denying access to essential inputs and by engaging in cross-subsidization, price squeezes, and discrimination. *See* AT&T Reply Comments at 13; *LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area*, 12 FCC Rcd. 15756, ¶ 134 (1997).

Attachment No. 1

THE INFORMATION CONTAINED IN THIS ATTACHMENT HAS BEEN REDACTED SUBJECT TO PROTECTIVE ORDER IN WC DOCKET NO. 02-112, CC DOCKET NOS. 00-175, 01-337, 02-33